Lowndes

Insights

What You Need to Know about Small Business Loans under the CARES Act

Article
Lowndes
03.30.2020

Related Attorneys

Nicole C. Leath

On Friday, the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which aims to provide economic relief to both businesses and individuals impacted by COVID-19. While the CARES Act includes a variety of relief measures, including tax benefits and credits, appropriations to support America's health care system, expansion of unemployment insurance, and direct payments to individuals in the form of tax credits, no measure may be more immediately impactful on businesses than the Paycheck Protection Program.

The Paycheck Protection Program incentivizes businesses to retain employees by making federally-guaranteed loans available to eligible businesses to pay payroll costs, along with rent and certain other expenses, which will then be forgiven. While the loans will be processed through the current SBA loan program, the application process has been streamlined and business eligibility has been vastly expanded. To apply for a covered loan, you should contact a lender that generally issues SBA loans.

A business is eligible if it employs 500 or fewer employees. However, businesses in certain industries, such as hotels and restaurants with multiple locations, may be allowed to calculate the number of employees under this test on a per-site basis. Further, borrowers must have been operating on or before February 15, 2020, and must have been paying employees and applicable payroll taxes through a Form W-2 or independent contractors through a Form 1099.

While a typical SBA loan eligibility requirement is that the borrower is unable to obtain credit elsewhere, this requirement has been waived for the Paycheck Protection Program. Additionally, the personal guaranty and collateral requirements of a traditional SBA loan have been waived. The maximum amount that businesses will be able to borrow is the lesser of: (a) $10 million or (b) the borrower's monthly average payroll costs (as determined based upon the payroll costs of the prior 12 months) multiplied by 2.5. Under the Act, "payroll costs" has an expansive definition (subject to

restrictions) that includes, among other expenses:

- Salaries or wages, not in excess of $100,000
- Payment for vacation, parental, and family leave
- Payment for medical or sick leave
- Payment for group health care benefits, including premiums
- Payment of retirement benefits
- State or local tax assessed on the compensation of employees
- Payment to any sole proprietor or independent contractor not exceeding $100,000

Under the Paycheck Protection Program, borrowed funds may be used to pay payroll costs, employee benefits, payments toward interest on mortgage obligations, rent, utilities, and interest on debt incurred before February 15, 2020. However, only expenses that are expressly set forth in Section 1106(b) of the Act and paid by the borrower during the 8-week period after origination of the loan are eligible for forgiveness. Such expenses include:

- Payroll costs (as defined above)
- Any payment of interest on any covered mortgage obligation
- Any payment of a covered rent obligation
- Any covered utility payment

The amount of the loan that is eligible for forgiveness will be reduced if the borrower reduces the number of its employees or reduces employee salaries beyond a certain threshold. The Act provides that any remaining balance on the loan after reduction due to forgiveness will have a maximum maturity of 10 years. Further, the maximum interest rate on a covered loan will be 4% during the covered period, and prepayment penalties have been waived. Loan payments for both principal and interest will be deferred for a minimum of 6 months and up to 1 year; however, interest will accrue from the loan origination date.

While loan forgiveness under this Act is considered canceled debt, the amount of loan forgiveness will not be treated as taxable income. It is important to note that the entire principal amount of the loan may not be forgiven depending on how the funds are used by the borrower. Although a borrower is permitted to use the funds for a variety of expenses, only payment of those expenses specifically set forth in Section 1106(b) of the Act will be forgiven, and the forgiven amount may not exceed the principal balance of the loan. Therefore, borrowers should be careful to incorporate all applicable payroll costs when calculating the maximum amount of the loan. Permitted costs not taken into consideration when making the initial loan principal calculation cannot be considered for forgiveness. If any portion of a loan under this program is forgiven, businesses may not be able to take advantage of other benefits under the Act, such as the payroll tax deferral.

Prior to applying for a loan under this program, businesses should consult with their counsel and review any existing loan agreements to prevent engaging in activity that could be a default on other loan obligations. Alternatively, existing debt may be eligible for refinancing through the Paycheck Protection Program. While this summary provides a brief overview, you should contact your attorney for specific recommendations on how your business may be able to take advantage of the benefits under the CARES Act.

The United States Department of the Treasury has made the following information available:

- General Overview
- Information for Borrowers
- Application